DEPARTMENT OF THE TREASURY
U.S. CUSTOMS SERVICE

HQ 545842 MAR - 7 1996

VAL RR:IT:VA 545842 LR

CATEGORY: Valuation

Leonard L. Rosenberg, Esq.
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RE: Sale for exportation; bona fide sale; transaction value; related parties; computed value; same class or kind merchandise

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Dear Mr. Rosenberg:

This is in response to your letter dated November 21, 1994, requesting a ruling on behalf of Perfect Industrial Uniform Manufacturing Co. ("the importer") on the valuation of uniforms to be imported from Honduras. Following our meeting in August, you made an additional submission on September 29, 1995. We regret the dealy in responding.

FACTS:

According to your submission, the importer is a supplier of uniforms in the United States. The importer established Chaloma MFG, S.A. ("manufacturer"), a wholly-owned assembly operation in Honduras and Perfect Shirt Corp. ("the middleman"), another wholly-owned company located in Honduras, which will provide certain administrative services to the manufacturer and will distribute the manufacturer's product. Under the proposed arrangement, the importer will purchase fabric and cut the fabric into pieces that may be assembled into uniforms and sell the pieces to the manufacturer who will assemble them into uniforms. The manufacturer will sell the uniforms to the middleman, who will act as the manufacturer's exclusive sales distributor regarding the resale of the uniforms to buyers in the United States. You indicate that the middleman will take possession and title at the manufacturer's factory and will assume risk of loss at that time. The middleman will then undertake to ship the uniforms to the United States and arrange for shipping. While the uniforms are in transit to the United States, the middleman will sell them to the importer, its exclusive distributor in the United States. The importer will serve as the importer of record.

You indicate that the manufacturer will make at least five percent profit on the labor and overhead costs it incurs in Honduras. These costs would include direct and indirect labor expenses, including all fringe benefits and first line supervisory personnel; rent, power and water for the manufacturing premises; leasing costs and/or depreciation for machinery and equipment required to produce the merchandise. Your original submission indicates that the middleman will pay for various of the manufacturer's administrative services including general manager, quality control supervisor, office equipment, janitorial and office supplies, kitchen and medical services, accounting and legal services. However, in your September 29, 1995 submission you indicated that what was intended by this statement is that the middleman will actually supply the manufacturer with the individuals and services. In other words, the services will be provided by employees of the middleman. It is our understanding that these services are to be supplied by the middleman to the manufacturer free of charge. Although no details regarding the services to be provided were furnished, you indicate that they will be of the type which Customs has previously ruled are not assists.

By way of illustration you describe how the transaction would be structured. The importer would purchase fabric for $2, cut it in the U.S. and sell it to the manufacturer for $3. The manufacturer would incur $3 in costs in assembling the cut components. The manufacturer would then sell, ex-factory, the completed uniforms to the middleman for $6.15 (earning a five percent profit on its labor and overhead costs). The middleman would take delivery of the completed uniforms at the factory, and send them to the U.S. While in transit, the middleman will sell the uniforms to the importer on a DDU (Delivered, duty unpaid) basis, the importer would enter the uniforms at the $6.15 sale price between the manufacturer and the middleman, claiming the appropriate deduction for the U.S. components under subheading 9802.00.80 HTS.

Three unsigned draft agreements between the parties which set forth details of the proposed arrangement were submitted. An agreement between the middleman and the manufacturer provides that the middleman agrees to purchase uniforms from the manufacturer and resell them to the importer or other buyers in the U.S. and to serve as the manufacturer's exclusive sales distributor for such uniforms assembled by the manufacturer. Under the agreement, the middleman is to purchase a specified minimum number of uniforms each year. The ex-factory prices are to be specified in the agreement. The agreement also provides that title and risk of loss shall pass to the middleman upon delivery of the uniforms to it at the manufacturer's facility. There is nothing in the agreement which indicates that employees of the middleman will provide any administrative services to the manufacturer free of charge or otherwise.

An agreement between the importer and the middleman provides that the importer will serve at the middleman's exclusive sales distributor for uniforms distributed by the middleman pursuant to the terms of the middleman-manufacturer agreement and that the importer will purchase the uniforms from the middleman for resale by the importer to a buyer within the United States. This agreement also specifies the minimum number of uniforms to be purchased by the importer at prices to be specified, DDU, U.S. port of delivery. The agreement provides that the importer will obtain title to the uniforms during their passage from Honduras to the United States

and that sale will be accomplished by the middleman endorsing the bill of lading to the importer. Under the agreement, risk of loss will pass upon delivery of the uniforms at the U.S. port.

The agreement between the importer and the manufacturer sets forth the terms and conditions regarding the sale of fabric pieces from the importer to the manufacturer for assembly into uniforms.

It is your position that the sale between the manufacturer and the middleman constitutes a sale for exportation to the United States and that the price actually paid or payable to the manufacturer by the middleman should be an acceptable transaction value. It is also your position that the in transit sale between the middleman and the importer cannot constitute a sale for exportation to the United States. Finally, it is your contention that if Customs determines that transaction value cannot be based on the manufacturer-middleman sale, and provided an election is made by the importer at the time of entry, appraisement should be based on the computed value of the merchandise utilizing an amount for profit and general expenses based on the manufacturer's profit and general and expenses.

ISSUE:

What method of appraisement is proper in the related party transactions described above?

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LAW AND ANALYSIS:

1. Transaction Value

Merchandise imported into the United States is appraised in accordance with section 402 of the Tariff Act of 1930, as amended by the Trade Agreement Act of 1979 (TAA; 19 U.S.C. 1401a). The preferred method of appraisement under the TAA is transaction value defined as the "price actually paid or payable for the merchandise **when sold for exportation to the United States**" plus certain enumerated additions. Section 402(b)(1) of the TAA (emphasis added). The "price actually paid or payable" is defined in section 402(b)(4)(A) of the TAA as "the total payment (whether direct or indirect . . .) made, or to be made, for the imported merchandise by the buyer to, or for the benefit of, the seller."

In order for transaction value to be based on the sale between the manufacturer and the middleman, it must be a *bona fide* sale, it must be a sale for exportation, and since the parties are related, it must be an acceptable transaction value as provided in section 402(b)(2)(B).

Is there a bona fide sale between the manufacturer and the middleman?

As the emphasized language makes clear, the transaction between the manufacturer and the middleman can be the basis of transaction value only if it constitutes a *bona fide* sale. *See* HRL 545714, November 9, 1994. Customs recognizes the term "sale," as articulated in the case

of *J.L. Wood v. United States*, 62 CCPA 25, 33, C.A.D. 1139, 505 F.2d 1400, 1406 (1974), as the transfer of ownership in property from one party to another for consideration. In determining whether a *bona fide* sale has taken place between a potential buyer and seller of imported merchandise, no single factor is determinative and the relationship is to be ascertained by an overall view of the entire situation. In a buyer-seller relationship the parties maintain an independence in their dealing, whereas in a principal-agency relationship, the principal controls the conduct of the agent with respect to matters entrusted to him/her. *See Dorf International, Inc. v. United States*. 61 Cust. Ct. 604, A.R.D. 245, 291 F. Supp. 690 (1968).

Several factors may indicate whether a *bona fide* sale exists between a potential buyer and seller. In determining whether property or ownership has been transferred, Customs considers whether the potential buyer has assumed the risk of loss and acquired title to the imported merchandise. *See* 545105, November 9, 1993; HRL 544775, April 3, 1992. In addition, Customs may examine whether the potential buyer paid for the goods, and whether, in general, the roles of the parties and circumstances of the transaction indicate that the parties are functioning as buyer and seller. *See* HRL 545571, April 28, 1995; HRL 545714, November 9, 1994. In HRL 545571, Customs determined that the circumstances of the transaction indicated that the middleman and the manufacturer did not act, respectively, as buyer and seller because of the control exerted by the manufacturer over the middleman. In that case, the evidence showed, among other things, that the manufacturer exerted considerable influence over the prices at which the middleman may offer merchandise to its customers and that the manufacturer issued all invoices and other paperwork relating to the middleman's alleged wholesale sales.

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The fact that in this case all three parties are related means that Customs will closely scrutinize the transactions to determine the actual roles of the parties. Based on the draft agreements and the information provided in the ruling request, it appears that there are two *bona fide* sales, one between the manufacturer and the middleman, the other between the middleman and the importer. The manufacturer-middleman agreement establishes the roles of the middleman and the manufacturer as buyer and seller and specifies when title and risk of loss pass to the middleman (*i.e.*, upon delivery of the uniforms to the middleman at the manufacturer's facility). The middleman-importer agreement, which establishes the roles of the middleman and the importer as seller and buyer, provides that title of the goods passes to the importer during their passage from Honduras to the United States upon endorsement of the bill of lading. The agreement provides that risk of loss passes to the importer upon delivery of the uniforms at the U.S. port. Under the terms of the agreement, the middleman will have title of the goods and bear the risk of loss for a period of time. The manufacturer-middleman agreement provides that the middleman will pay the manufacturer within thirty days after receipt of the uniforms and relevant invoices by a check mailed to the manufacturer. The middleman-importer agreement provides that the importer will pay the middleman within thirty days after receipt of the uniforms and relevant invoices by check mailed to the middleman. Both agreements are to specify the prices at which the uniforms will be sold.

Based on these provisions, there appears to be a transfer of ownership for consideration

first from the manufacturer to the middleman and then from the middleman to the importer. Provided the draft agreements are executed, the actions of the parties are consistent with those outlined in the agreements, and the parties otherwise transact business as buyer and seller, we find that there is a *bona fide* sale between the middleman and the manufacturer.

Is the sale between the manufacturer and the middleman a sale for exportation to the U.S.?

Counsel contends, and we agree, that the fact that the sale occurs within Honduras is not a bar to a finding that it is a sale for exportation to the United States provided that the goods were clearly destined to the United States at the time of such sale. See *Nissho Iwai American Corp. v. United States*, 786 F. Supp. 1002 (CIT 1992) *rev'd* 982 F.2d 505 (Fed. Cir. 1992); *E.C. McAfee Co. v. United States*, 842 F.2d 314 (Fed. Cir. 1988). In a three-tiered distribution system, a manufacturer's price to the middleman is valid so long as the transaction between the manufacturer and the middleman constitutes a viable transaction value. In reaffirming the *McAfee* standard, the court stated that in a three-tiered distribution system:

> The manufacturer's price constitutes a viable transaction value when the goods are clearly destined for export to the United States and when the manufacturer and the middleman deal with each other at arm's length, in the absence of any non-market influences that effect the legitimacy of the sales price. That determination can only be made on a case-by-case basis.

Id. at 509. *See also, Synergy Sport International, Ltd. v. United States* Slip Op. 93-5 (Ct. Int'l Trade, decided January 12, 1993).

Counsel contends that the merchandise is clearly destined to the United States because the merchandise is being ordered, produced, transported and sold amongst related parties for the sole purpose of ultimate importation into and sale in the United States. However, there is no indication that the uniforms are ordered by a specific customer in the U.S. prior to the manufacturer-middleman sale or that the uniforms are made to the specifications of a U.S. purchaser or are otherwise of such a type that they can only be sold in the United States. In fact, according to counsel, neither the manufacturer's commercial invoice nor the bill of lading mentions the importer or any other U.S. purchaser. While we agree that the intent of the parties as expressed in the submitted agreements is that the uniforms which the middleman purchases from the manufacturer are to be imported and sold in the United States, there is nothing which would prevent the uniforms from being sold outside the United States. Since the middleman takes title to the uniforms in Honduras before they are shipped, the middleman could sell them to another party in Honduras if it chose to. Based on the evidence before us, it has not been shown that the uniforms are clearly destined to the United States when sold to the middleman. Before transaction value could be based on the manufacturer-middleman sale, additional evidence is needed that the uniforms are "for exportation to the United States" at the time of such sale.

Is the sales price between the manufacturer and the middleman an acceptable transaction value?

Assuming the importer can establish that the goods are clearly destined to the United States at the time of the manufacturer-middleman sale, it must also establish that the sales price between the middleman and the manufacturer represents an acceptable transaction value. This is because the middleman and the manufacturer are related parties within the meaning of section 402(g) of the TAA. Imported merchandise may be appraised under transaction value only if the buyer and seller are not related, or if related, the transaction value is deemed to be acceptable. Section 402(b)(2)(B) of the TAA sets forth two methods under which a transaction value between related parties will be deemed acceptable. The first is where an examination of the circumstances of sale indicates that the relationship between the parties did not influence the price actually paid or payable. The second is where the transaction value closely approximates certain "test" values. 19 U.S.C. 1401a(b)(2)(B).

Under the circumstances of sales approach, if the parties buy and sell from one another as if they were unrelated, transaction value will be considered acceptable. Thus, if the price is determined in a manner consistent with normal industry pricing practice, or with the way the seller deals with unrelated buyers, the price actually paid or payable will be deemed not to have been influenced by the relationship. Furthermore, the price will be deemed not to have been influenced if it is shown that the price is adequate to ensure recovery of all costs plus a profit that is equivalent to the firm's overall profit realized over a representative period of time in sales of merchandise of the same class of kind. See Statement of Administrative Action (SAA), reprinted in Customs Valuation under the Trade Agreements Act of 1979, Department of the Treasury, U.S. Customs Service (October 1981) at 54; 19 CFR 152.103(j)(2), 19 CFR 152.103(l)(1).

Counsel contends that the price between the manufacturer and the middleman is not affected by the relationship of the parties since all direct and indirect costs of labor and processing, the cost of the material, as well as overhead costs will be included in the sales price and a five percent profit will be added, calculated on the direct and indirect costs of processing overhead incurred by the manufacturer. Counsel contends that the use of a cost-plus agreement mandating a five percent profit demonstrates that the relationship does not affect the transaction. Counsel states that this is the same method used by unrelated parties to ensure a profit where expenses could vary for a variety of reasons.

It is also counsel's position that the fact that the middleman will provide various services to the manufacturer free of charge does not impact on the determination that transaction value is the appropriate appraisement. It cites three Customs rulings which counsel contends stand for the proposition that administrative costs may be paid by or on behalf of the purchaser with no detriment to the finding of transaction value.

HRL 544323, March 8, 1990, one of the rulings cited by counsel, was issued in response to a request for a prospective ruling as to whether various items are assists under the TAA. One of the items at issue was the salaries and benefits for management and supervisory personnel

provided by the importer to its related seller. Although Customs concluded that these items were not assists under the TAA, the ruling did not address the issue of whether transaction value was acceptable. The ruling states only that:

> You state that 'Customs officials have previously reviewed the relationship between the importer and [the seller] and determined that the relationship does not affect the price actually paid or payable for the merchandise.' Therefore, for purposes of this ruling, we are assuming that transaction value is the proper appraisement method.

HRL 544421, April 3, 1990, another one of the cited rulings, involved facts which are similar to those presented here. In that case, the importer/buyer was to provide services and personnel to the manufacturer free of charge. In some cases, the manufacturer was related to the importer and in other cases it was not. The importer was to employ a plant manager, quality control supervisors and a supervisory engineer to supervise the factory operations and to provide secondary supervision and training, respectively. The importer was to pay for these individuals' salaries, and the payment was to be carried on the importer's books. Customs found that these salaries were not assists within the meaning of section 402(h)(1)(A) of the TAA. Customs also found that accounting services and legal services or cooking and medical services to be provided by the importer were not assists under that provision.

With regard to the applicability of transaction value, Customs concluded that "transaction value appears to be the proper method of appraisement for the transaction between unrelated parties". However, in the related party transactions, Customs held that the import specialist reviewing the entries must make the determination on whether the proposed transaction values are acceptable under one of the statutory tests. Thus, counsel is correct that in a related party situation, the fact that the buyer provides various services to the seller free of charge does not necessarily preclude the use of transaction value. However, the proposed transaction values must be acceptable under one of the statutory tests.

No information has been submitted which demonstrates that the price between the manufacturer and the middleman is settled in a manner consistent with the normal pricing practices of the uniform or garment industry, nor with the manner in which the manufacturer settles prices with unrelated buyers. It appears that counsel is relying on 19 CFR 152.103(l)(1)(iii) to demonstrate the validity of the manufacturer-middleman price. Under this provision, if it is shown that the price is adequate to ensure recovery of all costs plus a profit which is equivalent to the firm's overall profit realized over a representative period of time (e.g., on an annual basis), in sales of merchandise of the same class of kind, this would demonstrate that the price has not been influenced. However, we disagree with counsel's contention that the cost-plus five percent profit arrangement by itself demonstrates that the relationship does not affect the transaction. Since many of the manufacturer's administrative services are to be supplied free of charge by the middleman, we find that this method does not validate the manufacturer-middleman price. While the services supplied may not contribute to the manufacturer's direct cost of processing, they certainly would affect the amount of the manufacturer's overall profit.

Therefore, without including the costs borne by the middleman, we conclude that the cost plus profit formula cannot be used to validate the price. In addition, no information is available regarding the firm's overall profit realized over a representative period of time.

To the contrary, the fact that many administrative services are to be provided free of charge by the middleman, suggests that these parties do not buy and sell from one another as if they were unrelated. For example, it is doubtful that many buyers would chose to provide medical and legal services free of charge to an unrelated seller. While this arrangement would not necessarily preclude a finding that transaction value is acceptable, it must be taken into account along with the other evidence when analyzing the circumstances of sale.[1]

Alternatively, a transaction value between related parties is acceptable if it closely approximates certain "test values" for identical or similar merchandise. See 19 CFR 152.103(j)(2)(i). The term "test values" refers to values previously determined pursuant to actual appraisements of imported merchandise. We have no information regarding previously determined test values with respect to the imported merchandise.

Based on the evidence presented in the ruling request we are unable to determine that transaction value is acceptable based on the middleman-manufacturer sale.

If transaction value cannot be based on the manufacturer's price, can it be based on the middleman-importer sale?

Counsel contends that the sale between the middleman and the importer is not a sale for exportation because it occurs while the uniforms are in transit. It points to the fact that the middleman-manufacturer agreement indicates that the middleman will take possession and title at the factory and will assume risk of loss at that time and that the middleman-importer agreement indicates that the importer agrees to purchase and obtain title to the uniforms during their passage from Honduras to the United States. Under the agreement, that sale will be accomplished by the

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[1]Based on the information furnished it appears that the services to be provided by the middleman to the manufacturer would not constitute assists. However, without detailed information regarding the actual services to be provided by the middleman to the manufacturer, we cannot make any definite determination. It should also be noted if the middleman does not actually provide the administrative services to the manufacturer but rather, pays the manufacturer for them directly or pays an obligation on behalf of the manufacturer, it is likely that we would consider such payments to be part of the price actually paid or payable for the imported uniforms and part of transaction value. See HRL 544764, January 6, 1994 (pass-through payments by the importer to a party related to the seller for various expenses of the seller *e.g.* rent, salaried and indirect personnel, fringe benefits, leasehold improvements, professional services, etc. are part of the price actually paid or payable for the imported merchandise); HRL 545199, December 22, 1994 (funds for capital improvements provided by importer to producer, although not assists, are part of the price actually paid or payable for the imported merchandise).

middleman endorsing the bill of lading to the order of the importer and delivering the endorsed bill of lading to the importer. Risk of loss will pass upon delivery of the uniforms at the U.S. port. Counsel also points to the fact that the bill of lading will reflect the middleman as the specific consignee of the goods and that neither the bill of lading nor the manufacturer invoice will mention the importer.

We agree with counsel's contention that the sale from the middleman to the importer is not a sale for exportation to the United States and therefore cannot be considered as the basis for transaction value. In determining transaction value, a sale for exportation to the United States must take place at some unspecified time prior to the exportation of the merchandise. If the sale for exportation does not take place prior to the export of the goods, transaction value is inapplicable as a means of appraisement. See HRL 544628, March 11, 1992; HRL 543868, March 5, 1987.

The evidence presented in this case is consistent with a finding of an in transit sale. Therefore, such sale is not a sale for exportation to the United States upon which transaction value can be based.

Pursuant to the hierarchy set forth in the TAA, in the absence of transaction value of the imported merchandise or of identical or similar merchandise, the uniforms should be appraised using the deductive value method unless the importer properly requests the use of the computed value method. The ruling request provides that the importer will make such a request.

2. Computed Value

Section 402(e) of the TAA (19 U.S.C. 1401a(e)) provides:

(1) The computed value of imported merchandise is the sum of:

(A) the cost or value of the materials and the fabrication and other processing of any kind employed in the production of the imported merchandise;

(B) an amount for profit and general expenses equal to that usually reflected in sales of merchandise of the same class or kind as the imported merchandise that are made by the producers in the country of exportation for export to the United States;

(C) any assist, if its value is not included under subparagraph (A) or (B); and

(D) the packing costs.

Profit and General Expenses

Section 402(e)(2)(B) of the TAA states:

> (B) the amount for profit and general expenses under paragraph (1)(B) shall be based upon the producer's profits and expenses, unless the producer's profits and expenses are inconsistent with those usually reflected in sales of merchandise of the same class or kind as the imported merchandise that are made by producers in the country of exportation for export to the United States, in which case the amount under paragraph (1)(B) shall be based on the usual profit and general expenses of such producers in such sales as determined from sufficient information.

The SAA, adopted by Congress with the passage of the TAA, further explains that:

> The amount for profit and general expenses will be determined on the basis of information supplied by, or on behalf of, the producer and will be based upon the commercial accounts of the producer, provided that such accounts are consistent with the generally accepted accounting principles applied in the country where the goods are produced and unless the figures provided are inconsistent with those usually reflected in sales of merchandise of the same class of kind as the imported merchandise, that are made by producers in the country of exportation for export to the United States. . .
>
> The amount for profit and general expenses will be taken as a whole . . . Where the producer's own figures for profit and general expenses are not consistent with those usually reflected in sales of goods of the same class or kind as the goods being valued, which are made in the country of exportation for export to the United States, the amount for profit and general expenses will be based upon reliable and quantifiable information other than that supplied by or on behalf of the producer of the goods.

Based on the above, it is Customs position that a prerequisite for basing profit and general expenses on that which is reflected in the manufacturer's books is that the manufacturer's accounts must conform to "generally accepted accounting principles" (GAAP) of the country of production. Thus, in HRL 545088, September 26, 1994, Customs ruled that a prerequisite for granting a protest based on the claim that profit and general expenses under computed value should be based on the Mexican producer's books was that such books were kept in accordance with Mexican GAAP. See also HRL 544863, September 26, 1994; HRL 545116, April 7, 1994; HRL 542198, December 23, 1980. No information has been submitted which shows that the manufacturer's books are consistent with Honduran GAAP. Because of the proposed arrangement whereby many administrative services are to be provided free of charge by the middleman and carried on the middleman's books, this question should be closely scrutinized.

Assuming that the importer can establish that the manufacturer's books conform to Honduran GAAP, Customs must determine whether the manufacturer's profit and general

expense figures are acceptable. As indicated above, the TAA provides that computed value is to include "an amount for profit and general expenses equal to that usually reflected in sales of merchandise of the same class or kind as the imported merchandise that are made by the producers in the country of exportation for export to the United States". The TAA further provides that such amount shall be based upon the producer's profits and expenses, unless they are inconsistent with those usually reflected in sales of merchandise of the same class or kind as the imported merchandise that are made by producers in the country of exportation for export to the United States.

The amount for profit and general expenses will be taken as a whole. Where the producer's own figures are not consistent with those usually reflected in sales of goods of the same class or kind as the goods being valued, the amount for general expenses and profit will be based upon reliable and quantifiable information other than that supplied by or on behalf of the producer of the merchandise. See SAA and 19 CFR 152.106(c)(2). In HRL 544760, May 4, 1992, Customs determined that the import specialist was correct in rejecting the producer's "actual" profit and general expenses and instead using the usual profit and general expenses where the omission of various expenses from the producer's books resulted in profit and general expenses which were inconsistent with those usually reflected in sales of merchandise of the same general class or kind.

Merchandise of the same class or kind

Merchandise of the same class or kind means "merchandise (including, but not limited to, identical merchandise and similar merchandise) within a group or range of merchandise produced by a particular industry or industry sector." 19 CFR 152.102(h). As the definition makes clear, class or kind is broader than identical or similar merchandise. It is sufficient if the sale is of merchandise which is within a group or range of merchandise produced by a particular industry or industry sector.

In this case, merchandise of the same class or kind as the uniforms at issue would not be limited to uniforms. We consider textile uniforms to be within the textile garment industury or industry sector. Thus, we may look to the sales of textile garments manufactured by other Honduran producers for comparison purposes in order to determine whether the manufacturer's "actual" profit and general expenses may be used. However, 19 CFR 152.106(e) provides that sales for export to the United States of the narrowest group or range of imported merchandise, including the merchandise being appraised, will be examined to determine usual profit and general expenses. Thus, if there are other sales of uniforms made by Honduran producers, these sales should be looked to for comparison purposes. However, absent other sales of uniforms, Customs may look to other sales of other textile garments.

If, as a result of the proposed arrangement whereby the middleman will provide various administrative services to the manufacturer free of charge, the manufacturer's profit and general expenses actually incurred are inconsistent with other uniform or garment producers' profit and

general expenses, the manufacturer's figures will not be used. Customs will use instead the profit and general expenses usually reflected in sales of other garments. No information has been submitted regarding this issue.

If the uniforms cannot be appraised on the basis of transaction value or computed value, the merchandise should be appraised using the deductive value method if it is possible to do so.

HOLDING:

The information submitted is insufficient to establish the acceptability of transaction value based on the manufacturer-middleman sale. However, transaction value may be based on this sale if the importer can establish that the uniforms are clearly destined to the United States at the time of such sale and that such sale satisfies one of the related party tests discussed above. The proposed financial arrangement should be taken into account when addressing this issue.

In the absence of an acceptable transaction value based on the manufacturer-middleman sale, and transaction value of identical or similar merchandise, the uniforms should be appraised under computed value, assuming the importer so requests, subject to the following. If there are other Honduran sales of merchandise of the same class or kind as the uniforms at issue (*i.e.*, other uniforms, or in the absence of other uniform sales, other textile garment sales) the producer's figures for profits and general expenses may be used provided the producer's books are in conformity with Honduran GAAP and provided they are consistent with these other sales. If they are not in conformity with Honduran GAAP or are not consistent with the usual profit and general expenses incurred in the sales of the same class or kind or merchandise, the usual profits and general expenses incurred in these sales of the same class or kind merchandise should be substituted. The issue of whether the manufacturer's books conform to Honduran GAAP should be closely scrutinized.

Sincerely,

Thomas L. Lobred

Acting Director
International Trade Compliance Division

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November 21, 1994

Federal Express

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Washington, DC 20005

Perfect Industrial Uniform Manufacturing Co.
Request for Binding Ruling (Valuation)

Dear Mr. Fox:

On behalf of our client, Perfect Industrial Uniform Manufacturing Co. (PIU), and pursuant to Part 177, Customs Regulations, we hereby request rulings on the following:

1. that under the scenario set forth below, the in country sale between CHALOMA and PERFECT constitutes a sale for exportation to the United States that qualifies as transaction value under 19 U.S.C. § 1401a(b);

2. that the in transit sale from PERFECT to ~~CHALOMA~~ PIU, the importer, does not constitute a sale for exportation to the United States; agree

3. in the event there is no valid sale for exportation to the United States, that the dutiable value would be the computed value utilizing the profits and general expenses of CHALOMA, provided that the appropriate election to use computed value is made at the time of entry.

This ruling is being requested for a prospective transaction. To the best of our knowledge, a decision on a similar fact pattern has not been ruled upon by U.S. Customs.

Facts

PIU is an established supplier of uniforms to the U.S. trade. It does not supply uniforms outside of the United States. It produces uniforms on order and also maintains a supply of uniforms based on anticipated needs of its customers. PIU established CHALOMA MFG, S.A. (CHALOMA), a wholly-owned assembly operation in Honduras. In addition to establishing CHALOMA, PIU also established a second wholly-owned company PERFECT SHIRT CORP. (PERFECT), which will provide certain administrative services to CHALOMA and will distribute CHALOMA's product.

PIU will *sell* cut pieces of fabric to CHALOMA who will in turn assemble the pieces into various types of uniforms. The terms of the relationship between PIU and CHALOMA will be set by a "Sales Agreement" between the parties.[1] CHALOMA will then sell completed uniforms to PERFECT on an ex-factory, cost-plus basis. The terms of the relationship between CHALOMA and PERFECT will be set by a "Distributorship Agreement" between the parties. CHALOMA will make at least five percent profit on the labor and overhead costs it incurs in Honduras. These costs would include direct and indirect labor expenses, including all fringe benefits and first line supervisory personnel; rent, power and water for the manufacturing premises; leasing costs and/or depreciation for machinery and equipment required to produce the merchandise. PERFECT will pay for the general manager, quality control supervisor, office equipment, janitorial and office supplies, kitchen and medical services, accounting services and legal services. Expenses incurred by PERFECT will be in compliance with prior Customs rulings on what administrative costs of an Assembler/Manufacturer can be paid by a purchaser, but do not comprise part of dutiable value. PERFECT will then ship the merchandise to the United States. While the goods are in transit, they will be sold on DDU (Delivered, duty unpaid) basis to PIU. Under the terms of a Distributorship Agreement between PERFECT and PIU, title will pass to PIU upon receipt of the endorsed bill of lading and risk of loss will pass upon delivery to the port of importation. (b) (5) [redacted]

The following sets forth, *by way of illustration only,* how the transaction would be structured. PIU would purchase fabric for $2, cut it in the U.S. and *sell* it to CHALOMA for $3. CHALOMA would incur $3 in costs in assembling the cut components. CHALOMA would then sell, ex-factory, the completed uniforms to PERFECT for $6.15 (earning a five

[1] No agreements will be executed and no sales between CHALOMA and PERFECT will take place until the requested ruling is issued.

(b) (5) [redacted]

percent profit on its labor and overhead costs). PERFECT would take delivery of the completed uniforms at the factory, and send them to the United States. While in transit, PERFECT will sell the uniforms to PIU on a DDU basis. PIU would enter the uniforms at the $6.15 sales price between CHALOMA and PERFECT, claiming the appropriate deduction under subheading 9802.00.80.

Issues

1. Does the sale from CHALOMA to PERFECT constitute a sale for exportation to the United States that will be recognized as a transaction value under 19 U.S.C. 1401a(b).

2. Is the sale from PERFECT to PIU that takes place while the goods are in transit a sale for exportation to the United States.

3. Assuming no valid sale for exportation or transaction value, and assuming the answer to Issue 2 is in the negative, and further assuming that the appropriate election is made at the time of entry by PIU, would the Customs appraised value be determined by its computed value based on the cost or value of the components and fabrication costs incurred by CHALOMA plus CHALOMA's actual profit and general expenses, plus assists and packing costs which are not otherwise included.

Discussion

1. **The sale between CHALOMA and PERFECT constitutes a sale for exportation to the United States and the price paid or payable to CHALOMA by PERFECT should be acceptable as transaction value.** Transaction value is defined under 19 U.S.C. §1401a(b) as follows:

> ... the price actually paid or payable for the merchandise when sold for exportation to the United States[2] plus amounts equal to -
>
> (A) The packing cost incurred by the buyer with respect to the imported merchandise;
>
> (B) Any selling commission incurred by the buyer with respect to the imported merchandise;

[2] Pursuant to 19 C.F.R. § 152.103(a)(3), the price paid or payable could, in the appropriate circumstances, be represented by an assembly price.

> (C) The value, apportioned as appropriate, of any assists;
>
> (D) Any royalty or license fee related to the imported merchandise that the buyer is required to pay, directly or indirectly, as a condition of the sale of the imported merchandise for exportation to the United States; and,
>
> (E) The proceeds of any subsequent resale, disposal, or use of the imported merchandise that accrue, directly or indirectly, to the seller.

Section 1401a(b)(2)(B) further provides:

> The transaction value between a related buyer and seller is acceptable for the purposes of this subsection if an examination of the circumstances of the sale of the imported merchandise indicates that the relationship between such buyer and seller did not influence the price actually paid or payable; or, if the transaction value of the imported merchandise closely approximates -
>
> (i) the transaction value of identical merchandise, or of similar merchandise, in sales to unrelated buyers in the United States; or
>
> (ii) the deductive value or computed value for identical merchandise or similar merchandise ...

A. Sale for exportation

The fact that the sale we are seeking to qualify occurred within Honduras is not a bar to a finding that it is a sale for exportation to the United States. "First, a sale need not be to purchasers located in the United States to provide the basis for valuation. Second, if the transaction between the manufacturer and the middleman falls within the statutory provision for valuation, the manufacturer's price, rather than the price from the middlemen to its customer, is used for appraisal [citations omitted]. *E.C. McAfee Company v. U.S.*, 842 F.2d 314, 318 (Fed. Cir. 1988) (the transaction value of wearing apparel was based on the sales price from a tailor to a Hong Kong distributor, rather than the sales price from the distributor to specific U.S. customers at a marked up price.); *accord Nissho Iwai American Corp v.*

U.S., 982 F.2d 505 (Fed. Cir. 1992) (transaction value was based on the sales price of subway cars in Japan from the manufacturer to the parent of the importer rather than on the sales price from the importer to the ultimate purchaser); and, *Synergy Sport International Ltd. v. U.S.*, 17 CIT __, Slip Op. 93-5 (1993) (merchandise produced in China, sold to a Hong Kong distributor who then imported the merchandise into the U.S. and resold the merchandise to other parties was properly appraised at the price from the Chinese manufacturer to the Hong Kong middleman and not at the price from the middleman to the U.S. customer).

The foregoing cases amply demonstrate the status of the law on this issue. Sales to a middleman, whether the middleman is located in the country of production (*McAfee* and *Nissho Iwai*) or in a second country (*Synergy*) are not a bar to a finding of a sale for exportation based on the sale to the middleman. Whether or not the merchandise was on order in the U.S. prior to its manufacture is also not relevant to the decision. However, the fact that the merchandise was destined for particular customers in the United States is determinative of the fact that the merchandise was destined for the United States, thus a sale for export to the United States could clearly be established. The merchandise to be produced herein is from its inception destined for the United States. It is being ordered, produced, transported and sold amongst related parties for the sole purpose of ultimate importation into and sale in the United States. Therefore, the only remaining question is whether the sales price between CHALOMA and PERFECT is acceptable as a transaction value.

(b) (5) [redacted]

2. The transaction is not affected by the relationship. The price between CHALOMA and PERFECT is acceptable because it is not affected by the relationship of the parties. As indicated above, all of the direct and indirect costs of labor and processing, the cost of the material, as well as overhead costs will be included in the sales price between CHALOMA and PERFECT. A five percent profit will be added, calculated on the direct and indirect costs of processing and overhead incurred by CHALOMA. The use of a cost-plus agreement mandating a 5 percent profit demonstrates that the relationship does not affect the transaction. This is the same method used by unrelated parties to ensure a profit where expenses could vary for a variety of reasons.

(b) (5) [redacted]

The fact that PERFECT will pay certain CHALOMA administrative costs from its own accounts does not impact on the determination that transaction value is the appropriate basis of appraisement. Customs has held that payment of a variety of administrative costs, when paid 1) on or on behalf of the purchaser, does not affect the use of transaction value. For example: fees incurred in hiring an on-site inspection agent to verify quantities of components and of assembled garments returning to the U.S. are not part of the price paid or payable, nor does the fact that they are paid by the importer impact on the use of transaction value (HQ Ruling 543365); 2) accounting services, legal services and other administrative services performed by

(b) (5) [redacted]

(b) (5)

(b) (5)

U.S. buyers are not assists and their payment by the importer did not affect the use of transaction value (HQ Ruling 542122 (TAA No. 4) and HQ Ruling 544323); and, 3) Customs has also held that the payment for services of a cook and provision of medical services are also not assists and are not includable in transaction value if paid by the importer (HQ Ruling 544421). The foregoing Customs rulings, as well as many others which have not been cited, stand for the proposition that administrative costs may be paid on or on behalf of the purchaser with no detriment to the finding of transaction value.

Based on the foregoing, we believe that the sale between CHALOMA and PERFECT is a sale for exportation, and the price paid or payable, encompassing a five percent profit, should be accepted as transaction value.

3. The sale from PERFECT to PIU cannot constitute a sale for exportation to the United States. In the matter before you, CHALOMA is selling to its distributor, PERFECT, on ex-factory terms. PERFECT will take possession and title at the factory and will assume risk of loss at that time. PERFECT will then undertake to ship the uniforms to the United States and arrange for shipping. The bill of lading will reflect PERFECT as the specific consignee of the goods. Neither the bill of lading nor the CHALOMA invoice will mention PIU. PERFECT will enter into a separate distributorship agreement with PIU, which reflects that the uniforms are being sold on DDU basis with title passing on endorsement and delivery of the bill of lading, and with risk of loss passing upon delivery to the port of importation

A "sale" is defined as "a transfer of ownership and property from one party to another for a consideration. *J.L. Wood v. U.S.*, 62 C.C.P.A. 25, 33, C.A.D. 1139 (1974). In determining whether and when a sale takes place, Customs must determine whether there has been a transfer of property or ownership and whether the buyer has assumed the risk of loss as well as title to the imported merchandise.

Enclosed as *Exhibit A* are the pages covering DDU terms of sale as recited in the "Guide to Incoterms 1990," published by the International Chamber of Commerce. We draw your attention to the *Comments* box following paragraph "A5 Transfer of Risks." The second paragraph states as follows:

> All Incoterms, in conformity with the general principle of CISG,[3] connect the transfer of the risk *with the delivery of the goods* and not with other circumstances, *such as the passing of ownership* or the time of the conclusion of the contract. Neither Incoterms nor CISG deal with transfer of title to the goods or other property rights with respect to the goods. [Emphasis supplied.]

Although it is common for title and risk of loss to pass at the same time under the traditional FOB or CIF contract, the parties in this matter have chosen to structure their transaction differently. Title will pass on endorsement and delivery of the bill of lading, and risk of loss will not pass until after the goods are delivered to the port of importation. Accordingly, there is no transfer of ownership or property until the uniforms have left Honduras and are the subject of an endorsed bill of lading (title) and delivery (risk of loss).

Customs has found that an in transit sale may not serve as a sale for exportation to the United States. *See, e.g.*, Customs ruling 544628 which reflects this position. The rationale for all of this is quite simple. In order for it to be a sale *for exportation*, the sale must occur *before* the exportation occurs. In the case of sales between PERFECT and PIU, the sale occurs after exportation as reflected by the post sailing endorsement of the bill of lading and the terms of the Distributorship Agreement.

Accordingly, there being no transfer of ownership or property until after exportation from Honduras and because the sale that occurs takes place while the uniforms are in transit, the sale from PERFECT to PIU cannot be considered as a sale for exportation and the sales price between PIU and PERFECT cannot be considered as the transaction value.

4. In the absence of transaction value based on the CHALOMA to PERFECT sale, and provided an election is made by PIU at the time of entry, dutiable value will be based on the computed value of the merchandise as utilizing an amount for profit and general expenses based on CHALOMA's profit and general expenses. Pursuant to the hierarchy set forth in section 1401a, in the absence of transaction value of the imported merchandise, identical merchandise or similar merchandise, the deductive value of the imported merchandise is to be used as transaction value, provided that the importer does not request alternative valuation under section 1401a(a)(2). Pursuant to this paragraph, if the importer makes a request that computed value, provided for under 1401a(a)(1)(E), it will be the method of appraisement. Our request provides that such an election will be made.

(b) (5) [redacted]

[3] Convention on International Sale of Goods.

Pursuant to section 1401a(e)(1) the computed value of imported merchandise is the sum of:

> (A) the cost or value of the materials and the fabrication and other processing of any kind employed in the production of the imported merchandise;
>
> (B) an amount for profit and general expenses equal to that usually reflected in sales of merchandise of the same class of kind as the imported merchandise that are made by the producers in the country of exportation for export to the United States;
>
> (C) any assists, if its value is not included under subparagraph (A) or (B); and,
>
> (D) packing costs.

The same section under subparagraph (2) provides:

> The amount for profit and general expenses under paragraph (1)(B) shall be based upon the producer's profits and expenses, unless the producer's profits and expenses are inconsistent with those usually reflected in sales of merchandise of the same class or kind as the imported merchandise that are made by producers in the country of exportation for export to the United States, in which case the amount under paragraph (1)(B) shall be based on the usual profit and general expenses of such producers in such sales as determined from sufficient information.

Based on the foregoing, in the absence of 1) a finding by the Customs Service of what a producer's profit and expenses are usually reflected in sales of merchandise of the same class of kind as the uniforms imported by PIU; and, 2) a finding that the profits and general expenses of CHALOMA are inconsistent therewith, we submit that the profits and general expenses actually incurred by CHALOMA will be those used in determining the computed value of the uniforms imported by PIU.

Conclusion

We submit, based on the arguments made herein, 1) that the sale between CHALOMA and PERFECT constitutes a sale for exportation to the United States and qualifies transaction value; 2) that the sale between PERFECT and PIU does not qualify as a sale for exportation to the United States; and 3) if computed value is used, CHALOMA's profit and general expenses will be used to determine computed value.

Request for Conference

In the event you contemplate a decision which differs from that sought herein, we request the opportunity to consult with the appropriate Customs officials prior to any final decision being made.

Sincerely yours,

SANDLER, TRAVIS & ROSENBERG, P.A.

By: _____
Leonard L. Rosenberg

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August 15, 1995

Ms. Lorrie Rodbart
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1099 14th Street, N.W.
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Washington, DC

Hand-Delivered

PERFECT INDUSTRIAL UNIFORM MANUFACTURING CO.

Dear Ms. Rodbart:

Pursuant to your request, enclosed herewith please three draft agreements that will be executed amongst the three-named parties following approval of our request for ruling dated November 21, 1994. We believe that after you review these documents and the information contained in our ruling request, you will agree that the transactions presented constitute *bona fide* sales and that our request for ruling should be granted.

As always, we will provide you with any additional information you deem necessary.

Sincerely yours,

SANDLER, TRAVIS & ROSENBERG, P.A.

By: _____
Leonard L. Rosenberg

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Enclosures
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September 29, 1995

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Certified Mail-RRR

PERFECT INDUSTRIAL UNIFORM MANUFACTURING CO.

Dear Ms. Rodbart:

This letter clarifies the information contained in our ruling request dated November 21, 1994. These clarifications were requested in our meeting of August 15, 1995.

With respect to point 1 on p.2 of our original submission, we state that Perfect Shirt will pay for certain administrative expenses. What was intended by this statement is that Perfect Shirt will supply the individuals and services through Perfect Shirt employees. With regard to the second point raised at the meeting, whether PIU cut the components or purchased them from another source, they would be supplied to Chaloma on the same terms and conditions.

If you need any additional information, please feel free to contact me at your convenience.

Sincerely yours,

SANDLER, TRAVIS & ROSENBERG, P.A.

By: Leonard L. Rosenberg
Leonard L. Rosenberg

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